

Annual Meeting Report
June 6, 1978

Zayre

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To Our Shareholders:

Since it was not possible for many of you to attend the Company's Annual Meeting on June 6, 1978, in Boston, we have transcribed for your information the major addresses that were delivered at that meeting.

It should be noted that 4,046,869 of common shares, representing 81.5 percent of the total outstanding as of April 14, 1978, were represented either in person or by proxy at the meeting. In addition, 56,459 of shares of preferred stock were similarly represented.

The business of the meeting as set forth on the proxy dated May 2, 1978 was conducted in orderly fashion, and the management proposals set forth in the proxy were endorsed overwhelmingly by shareholder ballot. No other proposals were brought before the meeting.

Respectfully submitted,

Sumner Feldberg
SUMNER FELDBERG
Chairman of the Board

Maurice Segall
MAURICE SEGALL
President

Address by Sumner Feldberg, Chairman of the Board

Ladies and Gentlemen:

Before I proceed with my brief remarks, on behalf of the Board of Directors and Management of Zayre Corp., allow me to extend our warm welcome to all of you here today at our Annual Meeting of Shareholders.

I would like to keynote my talk by emphasizing that today, Zayre is a better company, fundamentally stronger than ever before. These are carefully chosen words—they were used in our recently issued Annual Report and bear repeating. In virtually all areas of our operations, the Company is functioning more cohesively and productively. Our momentum continues to build, and our results are beginning to attest strongly to the progress now being achieved.

Over the past three years, a great deal has been accomplished; there is no question, however, that a great deal more remains to be done and can be done to further improve our performance and, thus, enhance the value of your investment. I assure you that the management and personnel of Zayre are dedicated to this objective.

To achieve this goal we have, over the past few years, culled unprofitable lines of merchandise and replaced them with categories we seek to develop. Merchandise assortments and store presentations have been upgraded, bringing a new sense of excitement to our operations. Organizational changes and developments have made our merchandising groups more vigorous than in the past and have elevated the performance standards of all store management teams in the field.

With this improved operating effectiveness has come the consistent store-for-store volume gains we've achieved over the past two years and are continuing to register here in 1978. These gains in productivity, which I can now refer to as a trend, are a principal key to unlocking the huge potential for increased profitability inherent in our Zayre stores.

Financially, a whole series of steps have been taken that have strengthened our balance sheet ranging from the decision five years ago to reduce sharply the annual number of new store openings, to the elimination of our owned customer receivables, to the planned culling out of those stores and operations that did not fit into our longer term plans. In the Letter to Shareholders in our Annual Report, we list some of the figures which properly reflect the positive impact of these moves.

Improved financial strength has many benefits, not the least of which is lower interest costs. For example, later this month we will be putting into effect an improvement in the way in which we handle short term borrowings from banks in support of seasonal merchandise requirements. We will be changing from a structured credit agreement to open unsecured lines of credit with our 15 major banks in the aggregate amount of \$74 million, which is more than enough for our requirements. Borrowings under this arrangement will be at prime rather than at prime plus one-quarter of one percent, and there is no commitment fee for the unused portion of the line. This new arrangement will save the Company approximately \$250,000 per year.

With our balance sheet improved and good "asset management" a way of life, our focus and, indeed, our challenge, is to improve our level of earnings. While fiscal year-end sales and earnings were solid, management believes strongly that Zayre is today on the threshold of producing earnings results which are distinctly more commensurate with our volume and more indicative of the Company's capacity and industry position. Simply put, Zayre, as now structured, is just starting to tap its inherent earnings potential.

Our first quarter performance and the current tone of our business support our positive outlook. Sales for the first three months were ahead of plan, rising nearly 13 percent despite negative seasonal factors and an early Easter. Earnings, which were off slightly, reflect the intensity of our promotional programs and the disproportionately higher volume gains in non-apparel categories as consumers held off from buying higher margin soft goods during this cool and inclement Spring. I should stress that because of these factors, first quarter earnings are not truly indicative of our progress in the current year.

May sales were good and we expect this pattern to continue through the second quarter. Although the rate of gain may moderate somewhat in the second half, we expect earnings to strengthen through improved gross margins. In this connection, we note that with the advent of sustained warm weather over the past two weeks we have enjoyed a marked increase in apparel business.

Let me address next an issue that is often misunderstood. This Board of Directors is keenly aware of its responsibilities to you, the shareholders of this Company. Our duties and efforts are directed first at preserving your capital, next at enriching that capital and the market value thereof, and, finally, at having that capital provide a return through dividends. In this connection, it may be worthwhile to review the following.

Zayre began as a very small company and expanded rapidly—growing from \$17 million in sales to \$1.26 billion in just 22 years. A great deal of corporate debt was employed to finance so significant an expansion. Accordingly, in the early years, our rising earnings were retained so as to help support that growth. More recently, earnings have been retained so as to reduce the amount of financial leverage and achieve a sound balance sheet.

Now that this objective is in hand, only one hurdle remains to be overcome. Our earnings have to be brought up to a more appropriate level in order to support the immediate capital requirements of the business as well as provide for a meaningful dividend policy. Prudence dictates that the Directors protect your capital values by insuring that crucial inventory requirements and needed store improvements are covered adequately before initiating cash distributions.

I assure you that this matter is carefully and regularly considered by your Directors. We are today a great deal closer to a consistent dividend payout than ever before. Hopefully, as we achieve our objectives this year and next, circumstances will permit this to become a reality.

In conclusion, I would like to point out that over the years your Company has taken a whole series of steps designed to broaden, strengthen, and professionalize its management team and provide for sound succession. Just three months ago, Zayre announced the election of Mr. Maurice Segall as President and Chief Executive Officer of the Company to lead us on the next leg of our development. I will not embarrass him by reviewing his most impressive management credentials—a brief biography of Mr. Segall is contained in the Annual Report. I would say, however, that in the short span of time that he has been on board, he has demonstrated a first rate mind, outstanding qualities of decisiveness and leadership, and, above all, genuine concern and commitment to Zayre and its future.

Address by Maurice Segall, President, Chief Executive Officer

Thank you, Mr. Feldberg, for that very gracious and perhaps too kind introduction.

Ladies and gentlemen, the timing of this meeting is particularly appropriate since it is just about 90 days since I became President of Zayre Corp. I had targeted this time frame to acquaint myself with the organization, get a feel for how it operates, make initial judgments of key personnel and, of course, familiarize myself with a significant number of stores.

This meeting, then, offers me an opportunity to report to you on the results of this review and to share with you some of my reactions. But first of all, let me say categorically that I am absolutely delighted to be here and to have the privilege of heading up this very fine organization. My decision to join Zayre was based, in large measure, upon a personal desire to return to the very challenging and fast paced world of retailing, the industry in which I spent the first twenty years of my business career. Now, having had the chance to assess firsthand your company's many strengths, I can assure you that my personal satisfaction and ambition are indeed well framed.

At this juncture, I would like to pay special tribute to Mr. Stanley Feldberg who, as President of Zayre for many years, led the Company through its remarkable period of growth and established its reputation as one of the nation's leading retail organizations. These are large footsteps to follow, and I can only promise to do my best to maintain the Zayre tradition of vigorous and dedicated leadership.

I do want to stress that Zayre is, by any standard, a big company and I am impressed by its formidable strengths. In those areas in which I found what may be considered to be weaknesses, I am convinced that they are correctable. The combination of these reactions leaves me with a sense of real optimism for the future. In the short run, therefore, my major function is to capitalize on the strengths that are in place, to make sure that we make the most of them, even as we seek to identify ways to correct the weaknesses.

In outlining my first quarter program of work, I had set, as an objective, the examination of five key areas that would be most critical in making an evaluation of the state of the Company. These five key areas are:

1. Zayre's Retail Philosophy.
2. Retail Store Operations.
3. Responsibility to Customers and Public.
4. Financial and Business Planning and the Goal Setting Process.
5. Management Self-Renewal and Development.

The first question any new CEO would ask his organization is to define its philosophy of doing business—its mission if you will. In simpler terms, I have asked my associates what is a Zayre store supposed to be? It was defined for me as a neighborhood, convenience, self-service, general merchandise, discount department store. Just about everything we do at Zayre is geared to making that statement a living and profitable reality and not just an abstract concept or idea. It explains the whys and wherefores of our merchandise assortment plans, our approach to store labor costs, our pricing philosophy, and so forth.

I have examined that definition of a Zayre store and find it to be appropriate and acceptable for today's competitive market conditions. On the other hand, we may have, in certain places, taken the self-service portion too literally, and we shall re-examine the application of that concept in selected areas on a very careful basis.

Having defined the kind of store you want to be, the next step is to decide how you want to sell your goods or, using traditional business school language, what is your marketing and pricing philosophy?

Here, too, my associates seem to have carefully thought out the appropriate logistics. Zayre takes a strong price and promotional approach to its markets. This was not always the case. In the early years, Zayre did mostly institutional advertising, but the competitive environment changed and partly in response to these pressures, and also partly based upon our pricing philosophy, we became and are highly promotional—although not much more so than most leading discounters. With regard to this pricing philosophy, let me elaborate briefly. We do not and cannot aspire to be the lowest priced store in every town on every item. But, we are prepared to go to the mat on key identifiable items and to be certain that on the rest of the items in the store we are reasonably competitive. Overall, we would expect to be lower, on any given day, than most of our competition on most items.

We shall examine, very carefully, the degree to which we will continue to be as highly promotional as we are now. Needless to say, one must tamper with this particular method of doing business very carefully.

And finally, has Zayre drawn a careful bead on its customers? Does the Company understand who its customers are? Who they can be? Have we tailored our assortments, our price points, our advertising style and copy, and our in-store operations to our "customers"? That is a very big question—or rather a lot of questions that really gets to the heart of our business. Finding better answers and then implementing them in cost effective and profitable ways is very much a hands-on issue. In any case, I think there is room for

improvement, and I expect to get to it with the help of my associates who I know are keeping an open mind.

This brings us to the next area of my investigation, namely basic retail store operations philosophy. This is another key area on which we have to concentrate, and the Company has devoted considerable efforts in this area. I had visited Zayre stores many years ago, and there is no question that there has been great improvement in recent years. The difference between today's Zayre store and that of several years ago is like day and night, and yet, further improvement is still needed. So much is happening in the retail field with regard to day-to-day improvements in store design, decor, layout, and merchandise presentation that one has to run hard to keep even. If we want to be outstanding—and we do—we will just have to run harder. We have programs being tested in the chain that have great promise. Development work has been done in fourteen stores so far, and I am terribly excited about prospects for expansion of some of these concepts. For example, we have developed a loop layout that permits every department to front on the loop's main aisle, with a carefully thought through set of departmental adjacencies, geared to providing a convenient walk-through experience for our customers. But in addition to fixturing and layout changes, we have brought to bear a new and higher set of operating standards and merchandise presentation standards, the combination of which has resulted in solid and consistent sales gains. We are not yet finished, and development and experimentation continue even as we expand the concept. We think that we shall ultimately have a better mouse-trap than most other discounters.

In addition, last May a new program was started in the Indianapolis market. The results have been dramatic. I can tell you that when one sees sales increases of 30 percent and more, one can get very excited indeed. This program involves the following:

- A. To fix up stores and parking lots to make sure that the stores are shopable.
- B. Set and maintain high operating standards.
- C. Fill the store with dramatic quantities of goods, with emphasis on softlines.
- D. Provide more detail and more rapid replenishment backup than we typically do in other markets.
- E. Wrap it all up with an appropriate promotional program.

Thus, this program means high standards, loads of goods, and the best replenishment that we know how to provide. In the Fall, the program was expanded to Cincinnati, again with major increases in sales. With ample evidence that this program can work with dramatic effectiveness in two markets, we are now in

the process of expanding it still further to other key markets.

I rather briefly referred to, "the best replenishment that we know how to provide." I think it is fair to say that one of our great opportunities at Zayre is to improve our systems and operational approaches to merchandise replenishment in areas such as:

- A. Basic hard and soft goods.
- B. Seasonal goods.
- C. Event merchandise.
- D. Fashion apparel.

There are some short-run approaches that we can take to attack some of these problems, and there are also some longer-range approaches which involve significant modifications to our systems software and the question of point-of-sale registers and in-store, on-line terminals. This area is being explored with great speed.

It is, of course, a fact of life in our industry that it is always easy to target a major effort in a limited number of stores. The real trick is to transport those efforts so that the efforts that were successful locally can be successful throughout the chain. A major part of my effort over the next year will be to make sure that we have the necessary Home Office and regional support and the personal commitments from the people who have to make it work in order to spread the lessons that have been learned to date. It is clear that these directions give us a great opportunity and impetus for significant sales and profit gains.

Corporate responsibility to customers and the public is too frequently overlooked. As a company with millions of customers, I assure you that it is of great importance. I would say that Zayre's performance in this area has been little short of outstanding. Our Consumer and Community Affairs Department was one of the first in the industry, and it may be the only one of its type in the discount industry. The group is innovative and dynamic and we are eminently satisfied with the concept. If execution in the field is less than perfect, we are, at least, constantly striving for perfection with training programs, and we have the ability to react quickly to problems as they arise.

Legislatively, the Corporation has moved into a higher profile and participates actively in formulating legislative policies within lobbying organizations, national and state, to which we belong. The Massachusetts controversy over the proposed repeal of the Blue Laws was handled effectively and with dignity, and we believe that the Company's leadership position on this controversial issue contributed in a favorable way to the Company's image.

One overall reaction that I have had is that we, at Zayre, do a great deal of sophisticated financial plan-

ning. I do not think, however, that our business planning has been of the same caliber. More importantly, I think that there has to be a more effective integration of business and financial planning. Financial plans, by themselves, are merely numbers. It is the integration of business plans that converts them to a moving, dynamic roadmap to profit. One of our objectives is to develop more structured short and long range business plans that will detail not only our financial objectives but also the mechanisms for achieving them. One of my personal goals is to tighten the management by objectives administrative system so that the achievement of objectives has a much higher priority than it has had heretofore. Indeed, achieving of agreed-to objectives will have to become the number one objective of every executive in the Company.

There is no question that Zayre has an effective Personnel Department and that it operates in a highly professional way. While I have seen some evidence of corporate capability for management self-renewal, I happen to believe we can do better in this area.

To the extent that we have weaknesses in management renewal, this impacts on the development of people's skills. If I may be permitted an analogy, Zayre has the building blocks in place, but more masonry work has to be done to cement the wall together. I might just say, in respect to both management and organizational planning, that my experience has usually been that success is quickest if it is based on self-generated growth and development of people. I think Zayre has a good foundation upon which to build. The importance of this point cannot be overstated.

Having gone through those five target areas of investigation, I would reiterate my overall satisfaction and sense of optimism that we can improve in the areas that need improvement even as we continue to move forward aggressively. One of the major watchwords that will require concentration is the word productivity, especially sales productivity. Productivity gains, after all, fall to the bottom line more effectively than any other kind of advancement we can make. In this regard, it might be interesting to quote from a speech that I have made to the people throughout the organization. If I quote from that speech, it is not from a sense of pride of authorship, but rather because it is illustrative of an overall theme that we will be pursuing in the thrust for improved productivity:

“The word ‘excellence’ is a word that we will want to use—and exemplify—more and more in the future. A major contributor to effective earnings performance is excellence, but not just excellence in the abstract, not just excellence as a concept—that is relatively easy. The thing that we have to strive for is excellence

in execution and excellence in performance. In my experience, that is where the difference lies between outstanding results and mediocre results. Excellence is almost always the key difference between one company's success and another's failure. Excellence is also the hallmark of individual advancement as supervisors, at all levels, are always looking to identify and reward excellence in personnel under their supervision.

"Let us make sure that we do have some common agreement on the word excellence. One of the advantages that a new President has is that he sees things with a fresh perspective. Thus, while many of you may be able to look back to what stores were like and to what the organization was like several years back and feel a sense of gratification in what has been accomplished, new eyes look for standards of excellence that are closer to absolute standards. In other words, the eyes that have been here may tend to judge standards on a more relative basis.

"As a result, some of you may consider my standards high, but that is the way it should be and that is the way it will be. Our stores must be invitingly clean. Merchandise displays must be meaningful in their organization, exciting in their presentation, and the goods have to be there when the customer wants them. We even look to excellence in communication. We can't afford to kid each other—dialogue between stores and merchandising has to be honest, but constructive, if we are to work well as a team. In the same sense, we will ask merchandising for a commitment to excellence in terms of merchandise selection, styling of lines, and in delivering the goods at the right time. If we are to compete for our customer effectively, we can settle for nothing less."

Now, lest these words seem gratuitous, let me emphasize that the entire organization is responding to this call for across the board excellence in our operations.

In conclusion, there is a host of detail that we might have chosen to bring before you today. There are many critical topics that concern us. We are absorbed with problems in replenishment, productivity, quality, merchandise presentation, decor, energy, and many more. We are digging into these and we shall tackle the whole list in an organized and structured approach.

Thank you.

* Zayre Corp.

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